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## DEBT RESOLUTION THROUGH MEDIATION: EXTENSION-RESEARCH LINKAGES

by

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**DEBT RESOLUTION THROUGH MEDIATION:  
EXTENSION-RESEARCH LINKAGES**

**Glenn D. Pederson\***

The policy issue of how to resolve the farm financial stress/farm debt problem has received widespread attention from agricultural economists (AAEA Task Force on Financial Stress 1987; Brake 1986; Hughes et al. 1986; Knutson 1985; Duncan 1985; Jolly et al. 1985) and other farm policy analysts. The initial challenge for economists was to characterize the problem and develop indicators of its extent and severity. The subsequent challenge has been to evaluate 1) the impacts of financial stress and 2) alternative private and public policy actions for mitigating the negative effects. In the process, an extensive and productive literature has been developed.

There is, however, a void in that literature concerning the analyses of state-level programs and policies such as: interest rate buydown programs, farm loan participation programs, state statutes on farm foreclosures, farm credit mediation and various other state laws. Some recent exceptions can be cited (Crowley 1987; Saxowsky et al. 1987; Pederson and Eidman 1986). One explanation for the lack of analyses is that research on these state-level initiatives is hampered by lack of adequate data bases. Most state-gathered, farm financial data sets are based on only one or two years of survey activity, where the scope of the questions is quite limited and the results are of questionable

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validity. Along that same line, farm credit mediation is relatively recent in its origin (the first programs were established in 1986) and no data has been assembled for economic analysis. In addition, the extension-research linkages for addressing current and future farm debt problems have not been widely explored or promoted.

The tasks of this discussion paper are to: 1) review briefly the concept of farm credit mediation and what it is designed to accomplish, 2) analyze the Minnesota mediation process and the role of the Minnesota Extension Service (MES), and 3) identify extension-research linkages at both the micro and policy levels in the areas of farm debt mediation, resolution, and management. The underlying objective is to promote ideas on how extension and research agendas and activities can be productively integrated to respond to farm financial and resource adjustment problems.

### **Farm Credit Mediation**

Although state mediation programs vary, the central feature of mediation legislation is that it provides for a statutory delay in the process by which a lender can exercise the right to collect on a nonperforming loan through foreclosure on a mortgage and/or repossession of property. Additionally, the farmer is provided assistance in documenting and analyzing his(her) financial position at the start of mediation. The delay, and the corresponding farmer-lender mediation sessions, provide an opportunity for parties to assess their individual financial, tax, and legal positions and search for a settlement which is agreeable to both sides - the potential "win-win" solution. In cases

where no mediation settlement is reached, the benefit is that the debtor and creditor(s) have re-established communications for a time. The delay aspect is important, since it appears to have had the impact of reducing the rate of foreclosures and bankruptcy filings in Minnesota during 1986-87. The implication is that mediation has slowed the rate of resource/debt adjustment and has led to a further cumulation of losses for farm lenders.

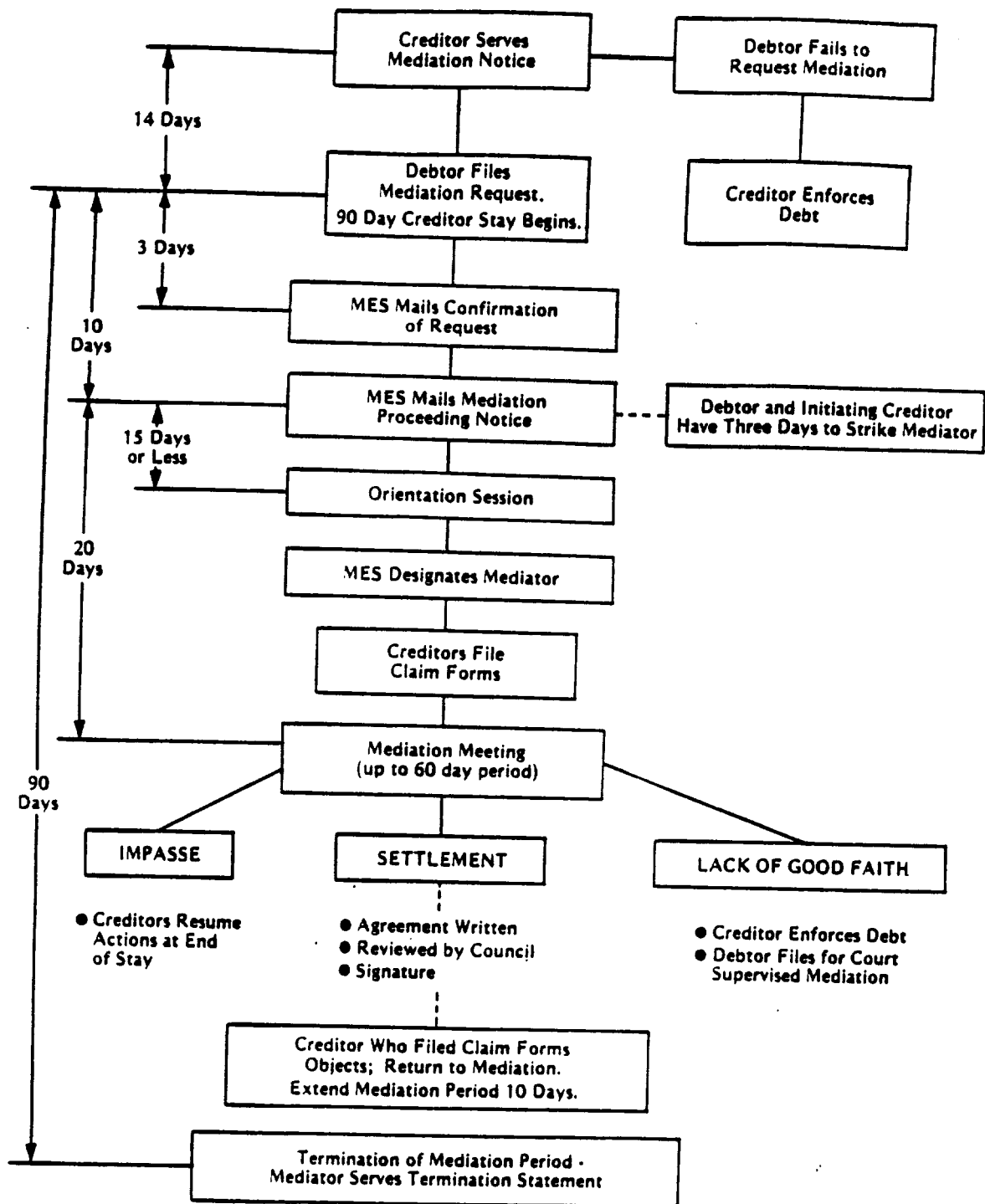
Mediation may be voluntary or mandatory. When it is mandatory, mediation activity is required (if requested by either party) under state law before a creditor can proceed to collect on a farm debt. Mandatory mediation can be initiated by either the debtor or the creditor. Under creditor-initiated mandatory mediation, the creditor is required to file a request for mediation with the designated mediation service. Return notification of the date of the initial mediation meeting (in Minnesota) starts the mediation "clock." The debtor has the option to accept mediation, or do nothing and waive the right to mediation. When the notification period tolls, the creditor may pursue collection through foreclosure or other legal remedies.

Figure 1 portrays the farm mediation process in Minnesota. The entire mediation period is 90 days after creditor notification has been served and the debtor has responded.<sup>1</sup> Any of 3 potential outcomes

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<sup>1</sup> If lack of good faith is found on the part of the creditor, an affidavit is filed by the mediator and the creditor's remedies are suspended for an additional 180 days. Lack of good faith may be found when parties; fail to attend, fail to provide full information, fail to provide a written statement of alternatives, or fail to release funds. Lack of good faith has been reported in a minority of cases in Minnesota.

FIGURE 1. STEPS IN MINNESOTA'S MANDATORY FARM MEDIATION



Revised 5-30-87

Note: Creditors' stay may be shortened or extended due to provisions in the Act for agreement between debtor and creditor allowing creditor to proceed, for conciliation court decisions of release of collateral, and for District Court review of mediator's findings of good faith.

occurs at the conclusion of the mediation sessions: settlement, impasse, or lack of good faith. If the farmer and creditor agree to a settlement, the mediator prepares a Memorandum of Agreement which is reviewed by all parties and their attorneys. Once the agreement is signed, it serves as a legally enforceable contract and no further mediation of that debt is required under state law. If no settlement results, the mediator prepares a report that mediation has concluded with no agreement. At that point the negotiating parties are able once again to pursue alternative legal remedies.

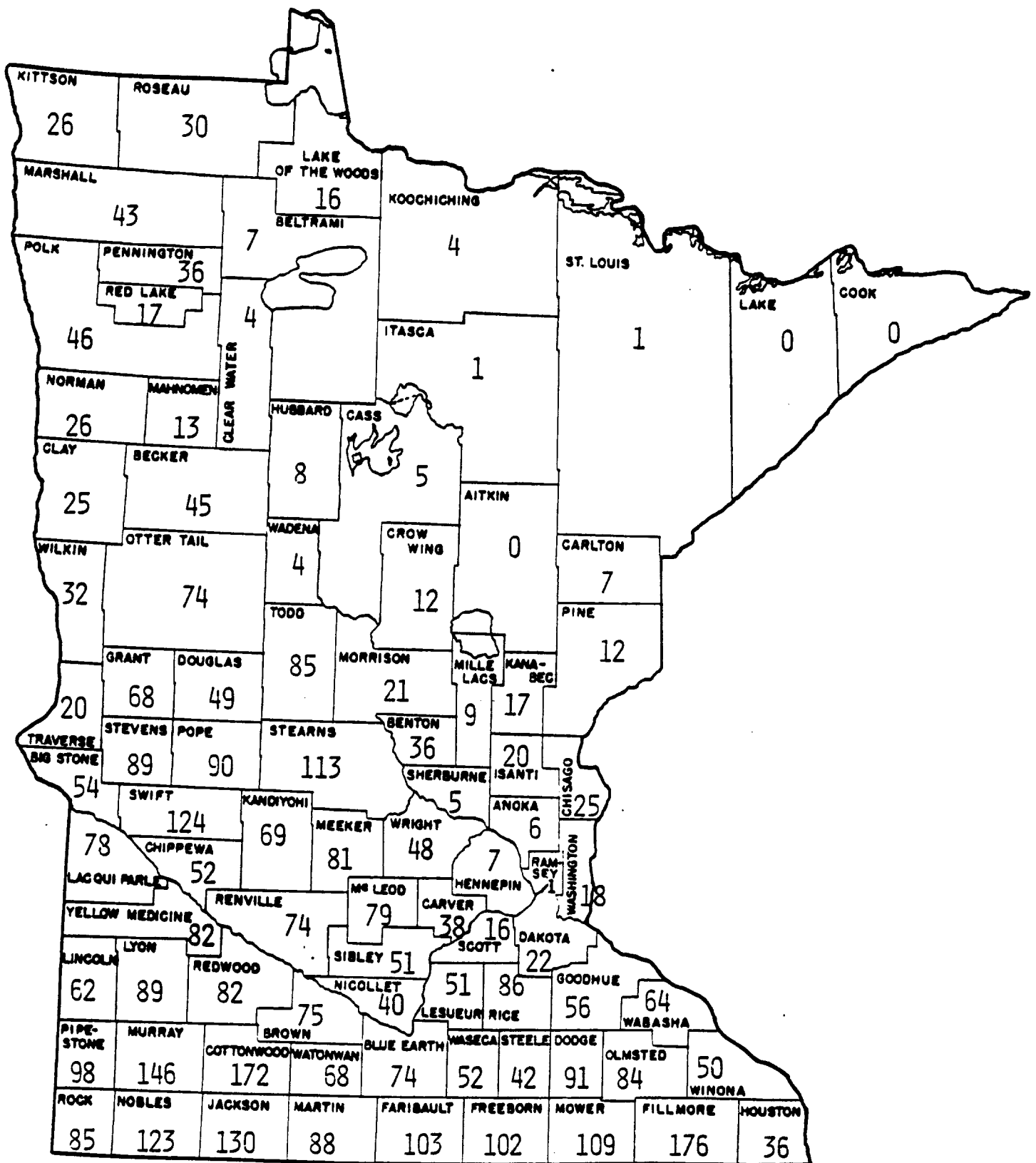
#### **MESs Role in Mediation**

Minnesota's 1986 mediation law applied to all agricultural property with a secured debt exceeding \$5,000. Amendments to the law in 1987 raised the qualifying debt amount to \$20,000. The initial low debt threshold and the relatively high incidence of delinquency on farm debt in 1986 produced a large caseload, especially in southern Minnesota (see Figure 2).

The MES was named in the state legislation to provide personnel and resources to administer the program, beginning March 1986. Funds totaling \$875,000 were appropriated by the Minnesota Legislature for the 1986-87 program, and \$535,000 for the 1987-88 program. The corresponding expenses of the MES were \$944,000 in 1986-87, and are projected to reach \$680,000 during 1987-88. The potential drain on the MES is \$214,000 over 2 years. MES support activities have included: processing of mediation notices; screening, training and assignment of mediators; extension agent assistance to the farmer in preparing



FIGURE 2. FARMER REQUESTS FOR MEDIATION (MARCH 1986 - JUNE 1987)



financial information and projections for the initial mediation session; maintenance of completed case files; and reporting to central MES personnel and the state legislature. The scope and level of involvement of the MES in farm mediation exceeded those of extension services in other states.

Based on 4,393 farmer requests for mediation in Minnesota between March 1986 and June 1987, the following cumulative distribution of cases has emerged: 487 cases were settled prior to the first mediation session, 1,175 cases were settled with an agreement (892 agreements involved a continuation of farming operations and 197 of the agreements terminated the farm business), 1,334 cases ended with no agreement, 129 cases were suspended due to lack of good faith, and 1,078 cases are still in progress. This indicates that just under 1 in 3 mediation cases (from those which have gone completely through mediation) resulted in an agreement which allowed the farmer to continue to operate. It is not known what percentage of those farms could be considered viable subsequent to restructuring.<sup>2</sup>

A major reason for the central role of the MES in farm mediation has been the availability of the FINPACK computer programs and past training of extension agents in the use of that software. It was recognized that mediation settlements involving debt restructuring would need to demonstrate debt repayment ability and sustained economic viability of the farm-household unit to be acceptable to creditors. To

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<sup>2</sup> An MES survey of mediation participants produced a range of estimates of the percent of farmers (who had settled their mediation cases) that would continue to farm between 27 percent (creditor estimate) and 40-50 percent (mediator and extension agent estimates).

meet that need the FINLRB program component of FINPACK generated whole-farm business summaries of profitability, liquidity, and solvency positions based on production plans, market prices, and financing arrangements which are assumed to be relevant for a 3-5 year planning horizon. Analysis of plans for financial adjustments in the farm business over time was also possible using FINTRAN (transitional whole-farm budgeting).

At a minimum, a baseline farm plan (current situation) was to be run on each farm prior to mediation negotiations. Alternative farm plans were to be run, if requested, for various debt resolution strategies such as; asset liquidations, deedbacks, debt adjustments, interest rate reductions, reamortizations, equity infusions, etc. The total number of FINPACK runs (primarily FINLRB - whole farm budgeting) was 7,547 through June 1987.<sup>3</sup> The county extension agent's support role was to obtain the necessary information from the farmer, execute the FINPACK program(s), provide an interpretation of the results of the baseline analysis at a mediation session, and perform additional analyses, if requested.

The MES conducted an evaluation of the program by analyzing a mail survey of 915 farmers, mediators, creditors and extension agents (Krueger et al. 1986). Based on an 80 percent response to the questionnaire, it was generally concluded that mediation had assisted farmers toward 1) improving economic viability of the farm unit or 2)

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<sup>3</sup> The total number of FINPACK runs translates into approximately two financial analyses per mediation case. The implication is that (on average) only one resolution strategy was analyzed in addition to the baseline projection.

leaving farming. A majority of the farmers who had completed mediation indicated that they would reduce the size of their operation (56 percent) and obtain additional off-farm income (59 percent). Significant percentages also indicated they would reduce family living expenses (37 percent) and change the mix of farm enterprises (23 percent). It was generally indicated that the program had improved communications between farmers and their lenders and lessened community tensions.

Problem areas also surfaced in the survey responses. Case preparation, session attendance, and paperwork required an average of nearly 40 hours per case of combined mediator, extension agent, and creditor time. Extension agents indicated that the increased time demands of the mediation program have been met by scaling-down or postponing agricultural extension programs or shifting certain responsibilities to nonagricultural agents or volunteers. Negotiations in the early (1986) cases were inhibited by reluctance of the Farm Credit Service to make concessions and lack of FmHA participation. Some farmers used the program to stall resolution of the debt problem, and there was widespread lack of adequate preparation for mediation. Mediators indicated that farmers were not nearly as well prepared for mediation as were banks, Farm Credit Services, FmHA, or insurance companies.

Lenders were most critical of the program and called for its termination citing the following reasons: 1) farmers did not perform after the settlement has been reached and most farmers in mediation were not running viable operations anyway, 2) many debtors not in mediation

were questioning their obligations to lenders, which had negative implications for credit standards, and 3) the program would seriously reduce the future availability of credit to other farmers. In spite of the problems and costs of the program most survey respondents (including many lenders) were generally supportive. This indicated that there had been a change in attitude from the time the program was initiated and a recognition of the benefits obtained through renewed communication between farmers and lenders.

Various research efforts are subsequently being conducted on Minnesota's farm mediation program such as; the role of mediation in family adjustment to crisis, the effect of timing in negotiation, and the broader public policy issues involved in initiating mediation. Although still in its initial stages, a research effort has begun focusing on the determinants of "successful" farmer-lender mediation. The study takes an econometric approach to determining the factors affecting the probability that mediation will result in a settlement agreement. Debtor, creditor and mediator characteristics, as well as location and timing determinants are being included in the independent variables set. A probability model will be used to test the hypotheses that 1) farmer personal and financial characteristics and preparation for mediation, 2) type and number of creditors involved and financial obligation to those creditors, and 3) mediator variables, significantly affect the probability of a settlement. Several implications may follow for future conduct of mediation programs, extension education programs, and development of farmer and creditor mediation strategies. These research efforts indicate the potential for a broader extension-

research involvement at the levels of farm management and policy analysis.

### **Extension - Research Linkages**

Although farm mediation and debt resolution have primarily involved extension support activities, the linkages between extension and applied research in farm financial management and policy are useful to explore. As an example of this linkage in the mediation area, past research and development of the FINPACK software and its extension at the county agent level has provided both the product and the support services to facilitate farm mediation. In Minnesota, the institutional capacity to respond existed prior to the advent of farm mediation. However, the FINPACK software was not designed to strategize across debt resolution strategies. The program requires the user (extension agent) be able to apply financial principles and concepts when identifying strategies for analysis, trained in its use, and knowledgeable of how to interpret the results.

Traditionally, the applied research appropriate to extension was problem-solving in nature with emphasis on analysis of management problems.<sup>4</sup> Increasingly, subject matter research on policy issues has become an important component of extension programming. In either setting it is instructive to consider two mathematical expressions:

$$f: x \rightarrow y$$

defines the function  $f$  as a "mapping or transformation" from the set  $x$

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<sup>4</sup> Johnson (1986) provides an excellent discussion of problem-solving, subject matter and disciplinary types of economic research.

into the set  $y$ . Further, the function may not be "single-valued" (i.e., more than one  $y$ -value may result from a given  $x$ -value). Consider "extension" as the set of activities denoted by  $x$  and "research" as the set of activities denoted by  $y$ . The function  $f$  is the process which "maps" economic problems faced by extension into a researchable problem, or set of problems. There is, by analogy, another function  $g$ ,

$$g: y \rightarrow x$$

which denotes the transfer of research results (new information, decision aids, etc.) back to extension for communication to rural and agricultural clientele. These two-way interactions are what constitute linkages.

Two points are worth emphasizing. First, these extension - research linkages should be broadly interpreted to include both: extension and research activities which an individual might be performing in an area of specialization, and the activities which separate extension and research individuals perform and communicate to one another. Second, where separate individuals are involved these linkages provide an opportunity for extension and research economists to challenge one another concerning the underlying problem/issue, the selection of an appropriate research approach, and the most effective way(s) in which to disseminate the research results.

These linkages occur at two levels of inquiry -- the micro/individual level and the policy/aggregate level. Micro linkages promote problem-solving -- identification, analysis, and development of aids to improve the quality of decisions at the firm/household level. Policy-level linkages are characteristically different due to their

subject matter focus, and the condition that they are not (to date) as well defined or extensively developed. The partial list of research issues in finance suggested by Lee (1987) contains six areas related to the farm financial crisis, which are relevant to the question of extension - research, policy-level linkages.<sup>5</sup>

The area of financial management, including farm mediation and debt resolution strategies, represents a potentially productive area for improving on past efforts and developing new, innovative linkages. A clear message that the farm mediation program has communicated through extension is that the abilities of that group of farmers are extremely deficient in the area of financial management. That deficiency includes both an inability to summarize past and current financial position and performance, and an inability to strategize about financial adjustments and their likely consequences. While a majority of the early mediation cases involved farmers who were not previous MES customers, inadequate farmer preparation for mediation was a widespread problem.

Past research on analysis of integrated risk management strategies, which has resulted in decision aids, needs to continue with a strong focus on how research products might be most effectively extended to users with limited background and formal training in farm finance and risk concepts. The "balance sheet approach" suggested by Barry and Boehlje (Hughes et al. 1986) provides a general framework for analyzing

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<sup>5</sup> Previous studies by Leathers and Chavas (1986) and Shepard and Collins (1982) provide some additional bases for extension-research consideration of the economic rationale for policy intervention under conditions of farm financial stress, and the significance of farm policy variables and other factors in the rate of farm bankruptcies.



the effects of alternative adjustments (or shocks) in the production, marketing and financing activities of the firm. It also indicates the relative effectiveness of actions when undertaken in combination for the purpose of restoring the "equilibrium" levels of business and financial risk. The approach has particular relevance for consideration of the role of financial leverage and farm-level adjustments in response to financial stress.

A possible innovation is to develop and apply an expert system to farm financial management problems.<sup>6</sup> An expert system is currently a research-oriented tool. However, with development and refinement a financial analysis expert system could be a means for raising the awareness of farmers and their lenders concerning the need for financial planning when borrowing and investing. An expert system could provide rapid feedback to the decisionmaker as to the financial feasibility and/or relative attractiveness of alternative management strategies and the need for adjustments. A significant amount of "learning" could potentially occur if a farmer and/or a creditor could interact with an expert system.

An expert system could be developed for an accounting/control model such as FINPACK. A financial analysis expert system of this type would require a knowledge base. The sources of data for that knowledge base include; financial statements (historical and proforma balance sheets, income statements, and source and use of funds), farm production

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<sup>6</sup> An expert system is a computer program that utilizes stored data and decision rules to mimic a human expert. Expert systems typically deal with situations characterized by a great deal of uncertainty (Senn 1987).

records, loan transactions and requests, and selected capital budgeting projections. Of course, this is a significant data requirement which initially limits its practical use and makes a human financial expert more appropriate. However, development of the financial analysis expert system and upgrading of the quality of farm management information would allow for rapid determination of 1) financial condition, 2) level of borrowing which will be required and serviceable, 3) need for debt adjustment/restructuring, and 4) feasibility of farm investments. Additionally, these questions could be addressed in the context of alternative levels of production, price, and policy risk. A limitation of this particular expert system is that it is applied to an accounting/control model which does not deal with the economic problem of optimal resource allocation.

### **Conclusions and Implications**

The tasks of this discussion paper have been to 1) review farm mediation and the role of the MES, and 2) examine the extension-research linkages. Two conclusions can be drawn at this point. First, given that farm mediation is a policy response to a crisis situation (which implies a massive caseload) it is not recommended that an extension service both provide technical support and administer the program -- as was the case in Minnesota. The MES is more effective in the former role with its capacity to provide educational and training programs for mediation participants. A related observation is that farm mediation (or any state-sponsored mediation activity) should be a fee-based service to cover mediator services and other direct expenses, as is the

case in other states with mediation programs.

A second conclusion is that extension-research linkages in the areas of management and policy are characteristically different. Existing extension-research linkages are operable, but in different ways. We need to consider ways to improve past linkages in the management area, and develop innovations in the products and services which are extended. There is also a need to foster the development of policy linkages in a number of emerging agricultural problem/issue areas. Farm mediation is an issue which cuts across management-policy lines. The implication is that linkages between extension and research activities relating to mediation are more complex, and require that we consider more effective ways to integrate our extension and research programs.

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